82-467 No.

Office - Supreme Court, U.S.
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ALEXANDER L. STEVAS
CLERK

IN THE

Supreme Court of the United States

October Term, 1982

SPLIT ROCK NURSING HOME,

Petitioner,

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., COMMISSIONER OF HEALTH OF THE STATE OF NEW YORK, RICHARD A. BERMAN, DIRECTOR OF THE OFFICE OF HEALTH SYSTEMS MANAGEMENT,

Respondents.

On Petition for a Writ of Certiorari to the New York State Court of Appeals

PETITION FOR A WRIT OF CERTIORARI

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Question Presented

Is the due process clause of the Fourteenth Amendment violated where a state administrative agency reinterprets a Medicaid regulation and applies the new interpretation retroactively to justify the seizure of thousands of dollars in reimbursement previously paid pursuant to the old interpretation?

Parties to the Proceedings

The names of all parties are contained in the caption of the case in this Court.

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No.

IN THE

Supreme Court of the United States

October Term, 1982

SPLIT ROCK NURSING HOME,

Petitioner,

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., COMMISSIONER OF HEALTH OF THE STATE OF NEW YORK, RICHARD A. BERMAN, DIRECTOR OF THE OFFICE OF HEALTH SYSTEMS MANAGEMENT,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE NEW YORK STATE COURT OF APPEALS

Split Rock Nursing Home respectfully petitions for a writ of certiorari to the New York State Court of Appeals to review the judgment of that Court.

Opinions Below

The opinion of the New York Court of Appeals is reported officially at 56 N.Y.2d 932 (1982); it has not yet been reported unofficially. The opinion of the Appellate Divi-

sion, Third Department, is reported officially at 85 A.D.2d 808 (3rd Dept. 1981) and unofficially at 445 N.Y.S.2d 638 (3rd Dept. 1981).

The opinions of the hearing officer and the Director of Health Systems Management are unreported, but can be found in the Appendix at pages 20a-32a and 8a-19a, respectively.

Jurisdiction

The judgment of the New York Court of Appeals, reversing the order of the Appellate Division, Third Department, was rendered June 17, 1982. This petition for certiorari was filed less than ninety (90) days from that date. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(3).

Constitutional Provisions and Regulations Involved

United States Constitution Amendment XIV

> Section 1. All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of any State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

10 New York Code of Rules and Regulations § 86.31*

> Incentive allowance; proprietary nursing homes. Within the rate of payment for proprietary nursing homes, an amount may be included as an allowable cost which is equal to a percentage established by the Commissioner to represent a sharing in the amount by which the total costs of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average ceiling of the costs of these services for the group. In instances where the latest survey disclosed significant deficiencies in the operation of a facility, the incentive allowance will not be available.

Statement of the Case

Split Rock Nursing Home (petitioner) is a private proprietary nursing home located in the Bronx, New York. During the relevant years—1972 and 1973—expenses incurred by petitioner in caring for Medicaid-eligible patients were reimbursed in accordance with federal and state statutes and rules promulgated by the United States Department of Health, Education and Welfare (now the Department of Health and Human Services) and the New York State Department of Health. See, generally, Title XIX of the Federal Social Security Act, 42 U.S.C. § 1396 *et seq.*; New York Public Health Law § 2807 (McKinney); New York Social Services Law §§ 363-368 (McKinney); 42 C.F.R. 430 *et seq.* (formerly contained in 45 C.F.R.); 10 New York Code of Rules and Regulations Part 86.

Under the federal Medicaid program, states are permitted to establish their own regulations, provided those

* This regulation was repealed on October 14, 1975.

regulations conform to the federal guidelines contained in 42 U.S.C. § 1396 (a). In order to encourage facilities to be cost efficient, the State of New York included an "incentive allowance" in its reimbursement regulations. Facilities which operated at a cost lower than the average of facilities in the same area and of the same size (the facility's "group") were given a portion of that cost-savings as an incentive unless "the latest survey disclosed significant deficiencies in the operation of [the] facility . . . ." 10 New York Code of Rules and Regulations § 86.31.

During 1972 and 1973, Split Rock Nursing Home, as a cost-efficient facility, qualified for and received an incentive allowance of approximately $90,000.

In January, 1975, Hugh Carey, the new Governor of New York, appointed Dr. Robert P. Whalen as the Commissioner of the Department of Health. In 1975, Commissioner Whalen repealed the incentive allowance regulation promulgated by the previous Commissioner of Health, who had been appointed by Governor Rockefeller.

In 1978, Commissioner Whalen revoked the incentive award previously paid to Split Rock in 1972 and 1973, and the Health Department seized approximately $90,000 from petitioner by withholding that amount from the reimbursement the home was entitled to receive in 1978.*

Petitioner's protest and request for a hearing were summarily denied by the Health Department. It was not until a court order was obtained by petitioner that a hearing was ultimately held.

---

* Additional sums were withheld relating to other items of reimbursement. Review is sought, however, only in connection with the incentive award.

The hearing officer appointed by the Commissioner of Health nullified the seizure; after hearing the testimony of Health Department officials concerning the interpretation and application of the regulation, the hearing officer found for petitioner in accordance with the interpretation given to the regulation by the Health Department during the years in question.

But the Commissioner of Health overruled his own hearing officer and approved of the seizure. The Commissioner based his ruling upon a "new interpretation" of the regulation governing the incentive program which, in fact, amounted to adding requirements never previously required.

Petitioner commenced a proceeding in the New York Supreme Court to set aside the Commissioner's order. Pursuant to state law (New York Civil Practice Law and Rules 7804(g) (McKinney)) the proceeding was transferred to the State Appellate Division, Third Department. A unanimous Appellate Division annulled the Commissioner's order, finding* that petitioner was entitled to the incentive award under the regulation as interpreted by the Health Department at the time the award was granted. The Appellate Division also found that the decision to revoke the incentive award was based on a "new interpretation" of the regulation, that the new interpretation was "not supported by any administrative precedent, written or otherwise," and that the new interpretation was set forth in writing for the first time "four years after repeal of the

* The factual findings of the Appellate Division were final and binding on the parties and not subject to review by the Court of Appeals. N.Y. Const. art. 6, § 3.

regulation and two years after petitioner first protested" the Health Department's seizure.* See Appendix C at 7a.

The New York Court of Appeals reversed, and reinstated the Commissioner's determination in a three sentence opinion, rendered after summary consideration and without oral argument. The Court concluded that it was bound by the Department's new interpretation of its own regulation as long as the Department was not acting in an arbitrary or unreasonable fashion.

Reasons for Granting Certiorari

POINT I

New York State Acted Unconstitutionally When It Seized Money Paid to Petitioner Years Earlier by Giving Retroactive Effect to a New Interpretation of Its Own Regulation

We do not believe that this Court has previously decided the precise question presented in this case—the constitutionality of applying a new interpretation of an existing administrative regulation retroactively and thereby revoking previously vested rights. However, this Court has addressed the retroactive effect of new regulations and statutes, and has repeatedly refused to allow retroactive

* Petitioner argued in its brief to the Appellate Division that the Health Department's retroactive revocation of the incentive award violated due process. Although the Appellate Division did not specifically address that issue, the Court's opinion implicitly adopted petitioner's due process claim. The Court of Appeals determined the case on the Appellate Division briefs and letters of submission pursuant to the Court's expedited summary procedure (New York Court of Appeals Rules § 500.2).

application which would deprive a person of a right that had matured. Those cases make it clear that petitioner's substantive due process rights under the Fourteenth Amendment were violated by the Health Department's actions in this case.

When an interpretation of a statute or regulation urged by an administrative agency will result in the forefeiture of a right previously matured, this Court has rejected the agency interpretation and insisted instead upon a construction which does not result in the forefeiture.

For example, in *Greene* v. *United States*, 376 U.S. 149 (1964), this Court refused to give retroactive application to a regulation of the Department of Defense despite the Department's claim that the regulation was intended to be retroactive. Under the retroactive application urged by the Agency—and rejected by this Court—Greene would have been deprived of rights which had already vested under the prior regulation.

Greene, an employee of a private corporation supplying military parts to the United States, was discharged by the corporation in 1953 because of the revocation of his security clearance by the Navy. In 1959 this Court ruled that the revocation was improper because Greene had been denied the right to confront and cross-examine his accusers, and remanded. Greene had obtained new employment, however, during the course of the litigation, but at a lower salary, and accordingly did not seek reinstatement after the remand. He sought only to recover compensation for the unauthorized discharge, relying on the regulations in effect at the time this Court remanded in 1959. The Department

of Defense refused to consider Greene's claim under that regulation, claiming that a newly adopted regulation governed. But the new regulation, issued after Greene's "claim had arisen and had been formally asserted" [376 U.S. at 153], substantially altered the rules applicable to compensation claims such as Greene's. Under the prior regulation Greene was clearly entitled to recover; under the new regulation his right to recover became dubious.

This Court refused to permit the Defense Department to apply its new regulation retroactively, and held that Greene was entitled to have his claim decided under the former regulation, ruling:

> Whatever petitioner's rights are, there can be no doubt they matured and were asserted under the [former] directive. Not until six months after petitioner formally presented his claim to the Department of Defense did the Secretary of Defense issue a new, and substantially revised, regulation concerning "monetary restitution". Thus the Government's argument necessarily requires that the [new] regulation be given retroactive application. As the Court said in *Union Pac. R. Co.* v. *Laramie Stock Yards Co.*, 231 U.S. 190, 199, "the first rule of construction is that legislation must be considered as addressed to the future, not to the past . . . [and] a retrospective operation will not be given to a statute which interferes with antecedent rights . . . unless such be 'the unequivocal and inflexible import of the terms, and the manifest intention of the legislature.' " Since requlations of the type involved in this case are to be viewed as if they were statutes, this "first rule" of statutory construction appropriately applies and under the circumstances, it would be unjustifiable to give the [new] regulation retroactive effect (footnote omitted).

376 U.S. at 160.

Similarly, in *United States* v. *Larionoff*, 431 U.S. 864 (1977) this Court refused to permit the Navy to apply a new statute retroactively which would have deprived individuals of rights already vested. At issue was the constitutionality of the Navy's attempt to restrict the right to re-enlistment benefits. The Navy sought to apply the new statute to individuals who had re-enlisted while the old statute was still in effect. Under the former statute they were entitled to benefits which the new statute took away.

This Court flatly rejected the Navy's attempt to apply the new statute retroactively, ruling:

> Thus, unless Congress intended, in repealing the VRB program in 1974, to divest Johnson of the rights he had already earned, and constitutionally could do so, the prospective repeal of the program could not affect his right to receive a VRB, even though the date on which the bonus was to be paid had not yet arrived.
>
> Of course, if Congress had such an intent, serious constitutional questions would be presented. No one disputes that Congress may prospectively reduce the pay of members of the Armed Forces, even if that reduction deprived members of benefits they had expected to be able to earn. Cf. *Bell* v. *United States*, 366 U.S. 393 (1961); *United States* v. *Dickerson*, 310 U.S. 554 (1940). It is quite a different matter, however, for Congress to deprive a service member of pay due for services already performed, but still owing. In that case, the congressional action would appear in a different constitutional light (citations omitted).

431 U.S. at 879.

The decision by the New York Court of Appeals is in conflict with the foregoing decisions of this Court. It is

also in conflict with decisions by various district and circuit courts interpreting and applying the federal Medicare program.

For example, in *Coe* v. *Secretary of Health, Education and Welfare,* 502 F.2d 1337 (4th Cir. 1974), the court refused to give retroactive application to a change in the Medicare reimbursement regulations although urged to do so by H.E.W. Coe had undergone medical treatment at a time when the regulations authorized reimbursement for such treatment. The regulations were thereafter changed to exclude reimbursement for such treatment. H.E.W., relying on the new regulations, refused to pay for the services. But the court ordered payment, concluding that retroactive application of the new regulation would result in "manifest injustice."

Similarly, in *South Windsor Convalescent Home, Inc.* v. *Weinberger,* 403 F.Supp. 515 (D. Conn. 1975) *rev'd on other grounds,* 541 F.2d 910 (2d Cir. 1976), the court, despite the urging of H.E.W. refused to give retroactive application to a new Medicare regulation. An old regulation had permitted the nursing home to depreciate capital assets by a particular accounting method; a new regulation thereafter promulgated barred the use of that accounting method. H.E.W. attempted to utilize the new regulation in order to recoup the reimbursement previously given to the nursing home under the old regulation. The court refused to permit recoupment, concluding that retroactive application of the new regulation would constitute a violation of the due process clause of the Fifth Amendment. *See also, Johnson* v. *Finch,* 328 F.Supp. 1169 (E.D. La. 1971).

From all the foregoing cases, the rule that emerges is quite clear: when vested property rights are at issue, a court may not defer to an administrative agency's new interpretation of an existing regulation on the grounds that the interpretation is "reasonable" in the abstract. The critical issue is whether the new interpretation is to be prospective or retroactive as well. Prospective application of the new interpretation may pass constitutional muster. But the Fourteenth Amendment bars a retroactive application which destroys vested rights.

In the instant case, the New York Court of Appeals ignored the constitutional implications of applying the Health Department's new interpretation retroactively.* Also ignored was the effect that a retroactive application of that interpretation would have on petitioner's vested rights. As a result, the State was permitted to seize more than $90,000 paid many years earlier to petitioner.

Under New York Law, reimbursement, once received, is a vested property right protected by due process. *E.g., Birchwood Nursing Home* v. *Whalen*, 70 A.D. 2d 1020, 418 N.Y.S.2d 212 (3rd Dept. 1979). This Court's rulings in *Greene* and *Larionoff* declare that such rights cannot be taken away by a retroactive application of a regulation or statute.

In *Greene* and *Larionoff*, it should be noted that the rights in question had matured, but the benefits had not been received. In the instant case, the rights had matured

* The Court also ignored New York's Administrative Procedure Act which prohibits "retroactively chang[ing] a valid declaratory ruling. . . ." New York State Admin. Proc. Act § 204 (McKinney).

and the benefits had been received; the Health Department had paid the money to petitioner many years before, unconditionally. We submit that the constitutional infirmity is more egregious in the instant case.

Petitioner was entitled to rely on the Health Department's prior interpretations. *Cf. Udall* v. *Tallman*, 380 U.S. 1 (1965). During 1972 and 1973 as a result of its efforts to reduce costs, petitioner properly received an incentive allowance in accordance with the program as then interpreted and applied. Petitioner was entitled to rely on that interpretation and to treat the incentive allowance as its own money absolutely and unconditionally. To permit that money to be taken back years later by virtue of a "new interpretation" of the regulation publicly issued for the first time in the Health Commissioner's decision in this case is fundamentally unfair, and thus a clear violation of due process.

POINT II

This Case Presents a Question of Continuing National Importance

The questions raised in this case involve the integrity of a national program established by the Federal Government for "the purpose of enabling each state . . . to furnish medical assistance . . ." to the needy. 42 U.S.C. § 1396. We submit that the decision of the New York Court of Appeals, if left intact, will impact negatively on the administration of that program. Accordingly, this case presents a question of national importance which should be decided by this Court.

The Medicaid system, created by Congress in 1965, has been described as "the largest and most significant piece of social legislation ever to pass the Congress . . ."* Billions of dollars of federal funds are made available each year to state governments which have submitted a plan approved by the Department of Health and Human Services. The federal enabling legislation sets forth strict guidelines for the states which act as agents of the federal government in administering the program on behalf of Health and Human Services. 42 U.S.C. § 1396(a). Volumes of regulations, both federal and state, control the reimbursement system and related questions.

The unconstitutional seizure of petitioner's funds threatens the integrity of the federal program, a program established to provide necessary medical treatment to the indigent. The program requires broad provider participation, which in turn requires reasonable assurance that providers will be treated fairly. It is fundamentally unfair to allow an agent of the Federal Government—here the New York State Department of Health—to alter the rules for reimbursement in order to seize money previously paid to and spent by the providers. Such a result would not only be fundamentally unfair and unconstitutional. It would also be self defeating: it would discourage qualified providers of medical services from participating in the program; they would no longer be able to rely on the integrity of the United States Government.

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* Statement by Senator Russell B. Long, July 6, 1965, III Cong. Record 15037.

The action of New York, if condoned, would encourage other states to ignore constitutional imperatives in acting as agents for the Federal Government. The precedent is dangerous, and should be rejected by this Court.

Conclusion

The petition for a writ of certiorari should be granted.

Respectfully submitted,

ROBERT A. GOLDSCHLAG
Counsel of Record

JACK S. HOFFINGER
ROBERT Z. DOBRISH
DAVID B. BERNFELD

HOFFINGER, FRIEDLAND & ROTH
Attorneys for Petitioner

September, 1982

APPENDIX A

Opinion of the New York State Court of Appeals (Dated June 17, 1982)

COURT OF APPEALS

STATE OF NEW YORK

In the Matter of the Application of

Split Rock Nursing Home,

Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

The Office of Health Systems Management of the Department of Health of the State of New York, the Hon. David Axelrod, M.D., Commissioner of Health of the State of New York, Richard A. Berman, Director of the Office of Health Systems Management,

Respondents.

On review of submissions pursuant to Rule 500.2(b), judgment insofar as appealed from by State respondents, reversed, without costs, and order of Director of Office of Health Management Systems reinstated as it pertained to petitioner's incentive allowance. The Director of the Office of Health Management Systems did not act arbitrarily or unreasonably in this case in disallowing petitioner's incentive allowance for the years at issue. Accordingly, the determination of the Director must be sustained (*Matter of Cortlandt Nursing Care Center* v. *Whalen*, 46 N.Y.2d 979).

Chief Judge Cooke and Judges Jasen, Gabrielli, Jones, Wachtler, Fuchsberg and Meyer concur.

APPENDIX B

Order of the Appellate Division, Third Department (Entered January 6, 1982)

At a Term of the Appellate Division of the Supreme Court of the State of New York, held in and for the Third Judicial Department in the City of Albany, New York, commencing on the 5th day of October, 1981.

Present:

Hon. T. Paul Kane — Justice Presiding,
Hon. Robert G. Main
Hon. Ann T. Mikoll
Hon. Paul J. Yesawich, Jr.
Hon. J. Clarence Herlihy — Associate Justices.

County Clerk's Index No. 517/80

In the Matter of the Application of

Split Rock Nursing Home,

Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

The Office of Health Systems Management of the Department of Health of the State of New York, the Hon. David Axelrod, M.D., Commissioner of Health of the State of New York, Richard A. Berman, Director of the Office of Health Systems Management,

Respondents.

Appendix B

Order of the Appellate Division, Third Department

The above-named petitioner having instituted this proceeding in Supreme Court, Albany County, pursuant to article 78 of the Civil Practice Law and Rules, to review a determination of respondents, dated January 30, 1980, and said proceeding having been transferred for disposition to the Appellate Division, Third Department, by order of the Supreme Court, Albany County, dated April 11, 1980 and entered in Albany County, and having been presented during the above-stated term of this court and having been argued by David B. Bernfeld, Esq., of counsel for petitioner and by Joseph Micare, Esq., of counsel for respondents, and, after due deliberation the Court having rendered a decision on the 17th day of September, 1981, it is hereby

ORDERED that the determination be modified, by annulling so much of the order of the Commissioner of Health as disallowed petitioner's incentive alowance, and as so modified, confirmed, with costs to petitioner.

ENTER:

JOHN J. O'BRIEN
Clerk

DATED AND ENTERED: January 6, 1982.

A TRUE COPY
/s/ JOHN J. O'BRIEN
Clerk

APPENDIX C

Opinion of the Appellate Division, Third Department

SUPREME COURT
APPELLATE DIVISION
THIRD JUDICIAL DEPARTMENT

December 17, 1981. 40400

In the Matter of SPLIT ROCK NURSING HOME,

Petitioner,

v.

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK et al.,

Respondents.

Proceeding pursuant to CPLR article 78 (transferred to this court by order of the Supreme Court at Special Term, entered in Albany County) to review a determination of the Commissioner of Health, which reduced petitioner's Medicaid reimbursements for the years 1972 and 1973.

Petitioner is a private nursing home located in the Bronx, New York, having opened for business in February, 1971. Its reports to the New York State Department of Health (Department) for the year 1971 established a prima facie basis for the grant of an "incentive allowance" pursuant to former section 86.31 of the Administrative Rules

and Regulations (10 NYCRR 86.31, repealed October 14, 1975). This section provided as follows:

> 86.31 Incentive allowance; proprietary nursing homes. Within the rate of payment for proprietary nursing homes, an amount may be included as an allowable cost which is equal to a percentage established by the Commissioner to represent a sharing in the amount by which the total costs of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average ceiling of the costs of these services for the group. In instances where the latest survey disclosed significant deficiencies in the operation of a facility, the incentive allowance will not be available.

Based upon an audit of 1971 operating costs, petitioner was granted an incentive allowance for the rate period effective July 1, 1972 through December 31, 1972, and, after a change in its fiscal year, for the period of January 1, 1973 to December 31, 1973. As a result of an audit report dated November 11, 1975, adjustments were made by the Department auditors, effecting a reduction in the Medicaid reimbursement for those years as well as a reversal of the incentive allowance.

Petitioner protested the reduction in its reimbursement rates (enforced by withholding sums of approximately $350,000 from petitioner in 1978) and a hearing was held in 1978. Following that hearing on the audit reductions, petitioner abandoned its claim of error as to many of the various accounting deficiencies charged to it upon the audit. However, petitioner continued to protest the disallowance of the incentive allowance and the finding that the reim-

bursement rate for the period at issue should be based upon petitioner's actual costs for 1971. It is those two items that petitioner continues to contest in this proceeding.

As to the use of actual 1971 costs for setting the rate used in the period of July 1, 1972 through December 31, 1973, the Director of the Office of Health Systems Management (Director) computed the utilization factor at 98.4%. Petitioner has failed to establish any mathematical error or legal error as to this issue.

As to the disallowance of the incentive allowance, the Director found:

> [t]hat certain personal expenses of the operator and patients' personal monies were included in the working capital and hence the equity of the facility for reimbursement purposes, and upon audit disallowed, it is the Director's conclusion that the Respondent's action in so including them were significant deficiencies in the operation of the facility, as described in § 86.31. The use of patient monies to enhance one's return on equity by improperly using that money to inflate a nursing home's equity is not a proper use of the patient's personal monies. An audit, such as performed by Mr Kern is a survey within the meaning of § 86.31, as the term "survey" is synonymous with the term "inspection" as set forth in Public Health Law § 2803(1)(b). Hence, the incentive allowance should not be available to * * * [petitioner].

An agency interpretation of its own regulation is entitled to great weight and will be upheld if not irrational or reasonable (e.g., *Matter of Johnson* v. *Joy*, 48 N Y 2d 689; *Matter of Bernstein* v. *Toia*, 43 N Y 2d 437). The testimony

adduced at the hearing made it clear that in 1971 the policy of respondent was to disallow incentive allowances only if a facility was on the significant operating deficiency list. Although one witness did testify that some time after 1974 the commissioner decided that incentive allowances should also be lost if an audit disclosed improprieties in a facility's record keeping, no memorandum or other writing was produced disclosing this change of position. In fact, the only writing describing respondent's new "interpretation" of section 86.31 is the commissioner's order in this case dated January 30, 1980, four years after repeal of the regulation and two years after petitioner first protested respondent's action.

Testimony at the hearing disclosed that surveys of the nursing homes were conducted by regional health directors to identify those facilities providing less than adequate care. Any facility so identified was not eligible for an incentive award. Respondent's construction of "significant deficiencies in the operation of the facility" to include improprieties in the record keeping of the nursing home is not supported by any administrative precedent, written or otherwise. Thus, it should be rejected and petitioner's incentive allowance restored.

Determination modified, by annulling so much of the order of the Commissioner of Health as disallowed petitioner's incentive allowance, and, as so modified, confirmed, with costs to petitioner.

KANE, J.P., MAIN, MIKOLL, YESAWICH, JR. and HERLIHY, JJ., concur.

APPENDIX D

Order of Richard A. Berman, Director, Office of Health Systems Management

(Dated January 30, 1980)

STATE OF NEW YORK

DEPARTMENT OF HEALTH

OFFICE OF HEALTH SYSTEMS MANAGEMENT

IN THE MATTER

OF

SPLIT ROCK NURSING HOME

Request pursuant to Section 86-2.7, Chapter II of the Code of Rules and Regulations of the State of New York

To: Split Rock Nursing Home
3525 Baychester Road
Bronx, New York 10466

Robert Dobrish, Esq.
Hoffinger, Friedland and Roth
10 East 53rd Street
New York, New York 10022

A hearing in the above matter having been held before Francis P. Mulderry, Esq, hearing officer designated pursuant to the Public Health Law of the State of New York,

Appendix D

Order of Richard A. Berman, Director, Office of Health Systems Management

and such hearing having been held on September 28, November 20, and December 5, 1978 in the hearing room of the Department of Health, Office of Health Systems Management, Nelson A. Rockefeller Empire State Plaza, Albany, New York and the World Trade Center 2, New York, New York; Office of Health Systems Management having appeared by Jerome T. Levy, Esq., and Melinda A. Bass, Esq., Counsel, Steven U. Teitlebaum, Esq., and Harriet Katz, Esq., of Counsel, the facility appeared by Hoffinger, Friedland and Roth, Robert Z. Dobrish, Esq., of Counsel, and transcripts of the proceeding having been made and exhibits received in evidence, and a hearing officer's report dated July 27, 1979, having been submitted, a copy of which is attached hereto, and made a part of this Order.

The Director adopts the Hearing Officer's findings of fact, opinions and recommendations as his own, with the following two exceptions:

A) In regard to the issue of basing a reimbursement rate on 1971 costs, the Director notes an additional finding of fact, in that the utilization factor was 98.4% (transcript pg. 122). In view of the fact that the utilization was over 90%, the Director hereby finds that the use of the cost report was proper in establishing a medicaid rate of reimbursement. This supplants the finding of fact noted by the hearing officer, to wit:

> "For 1971, Split Rock Nursing Home was slightly less than 90% capacity; i.e., 89.2% according to testimony of Ms. Wall. (Min. 11/20/78, p. 121)

Appendix D

Order of Richard A. Berman, Director, Office of Health Systems Management

B) The Hearing Officer's findings of fact in regard to the issue of the incentive allowance was as follows:

"Ms. Wall of the Health Department testified that an incentive allowance is granted to facilities operating without deficiencies at a cost below group average. (Min. 11/20/78, pp 87-8)

"Terry Opela is a fiscal analyst employed by the New York State Department of Health and has been so employed for some 5½ years. (Min. 12/3/78, pp 177-8)

"Mr. Opela stated that incentive allowances would be forfeited if the facility was placed on the "significant operating deficiency list". (Min. 12/5/78, pp 192-3)

"The Hearing Officer deduces that both parties concede Split Rock Nursing Home was originally granted an incentive allowance.

"Mr. Kern, Department's witness stated that elimination of incentive allowances is not an audit function. (Min. 11/20/78, p. 166)

"Ms. Wall testified that there were no regulations with respect to removal of an incentive allowance based upon audit, but she indicated a memorandum exists which says an incentive allowance may be removed if an audit shows personal expenses were included in the report. (Min. 11/20/78, pp 47-8)

The Director's additional finding of fact is based on testimony during cross examination on the subject of the incentive allowance from pp 88-91. The additional finding of fact is as follows:

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Order of Richard A. Berman, Director, Office of Health Systems Management

Ms. Wall, testified at page 48:

Q. No. What I mean is: There is, as I understand it, a regulation that says that a retroactive adjustment can be made by the Department based on an audit?

A. That's true.

Q. Is there any regulation, rule, procedure, memorandum or anything that you know about that states that an adjustment can be made on anything other than an audit?

A. There is a memorandum that says that the incentive can be taken out if the home—if the audit shows that there were personal expenses in the report.

Q. If the audit shows that there were personal expenses?

A. Yes.

Q. That would be based on the audit; wouldn't it?

A. Right, as far as I know it's all based on the audit.

Q. So that any adjustment that's made not based on an audit would have no authority for it, would it?

A. Not that I know of.

Additionally, Ms. Wall testified on page 90 that an incentive allowance could be lost on audit. While Ms. Wall testified at page 88, line 11, that she thought that § 86.31 referred to "significant operating deficiencies," § 86.31 actually stated as follows:

"86.31 Incentive allowance; proprietary nursing homes. Within the rate of payment for proprietary nursing homes, an amount may be included as an allowable cost which is equal to a percentage established by the Com-

missioner to represent a sharing in the amount by which the total costs of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average of the costs of these services for the group. In instances where the latest survey disclosed significant deficiencies in the operation of a facility, the incentive allowance will not be available."

This regulation remained in existence until October 14, 1975.

Mr. Opela (pg. 192-3) was aware of one aspect of losing the incentive allowance, that is the significant operating deficiency list. However, § 86.31 speaks of significant deficiencies in the operation of a nursing home, which would include a broader scope of activity.

In view of the Hearing Officer's finding of fact that in regard to Issue number 20 from the Notice of Hearing, that certain personal expenses of the operator and patients' personal monies were included in the working capital and hence the equity of the facility for reimbursement purposes, and upon audit disallowed, it is the Director's conclusion that the Respondent's action in so including them were significant deficiencies in the operation of the facility, as described in § 86.31. The use of patient monies to enhance one's return on equity by improperly using that money to inflate a nursing home's equity is not a proper use of the patient's personal monies. An audit, such as performed by Mr. Kern is a survey within the meaning of § 86.31, as the term "survey" is synonymous with the term "inspec-

tion" as set forth in Public Health Law § 2803(1)(b). Hence, the incentive allowance should not be available to Mr. Zelmanowicz.

The opinion of the Hearing Officer is stated as follows:

OPINION

"No Health Department regulations were in effect with respect to removal of incentive allowances other than for operating deficiencies. Internal correspondence referred to on this point did not exist during the year in question at this hearing.

"Therefore, it is the feeling of the Hearing Officer that removal of the incentive allowance was improper and it should be restored."

The Director overrules the Hearing Officer's conclusion that there was no regulation in effect with respect to removal of incentive allowances other than for operational deficiencies. In so doing, the Director takes official notice of 10 NYCRR 86.31 and Public Health law § 2803(1)(b).

C. UNCONTESTED ITEMS

Comissioner's Findings of Fact

The facility did not contest the following items from the Notice of Hearing:

"#3: Whether interest of $249. should not have been offset against investment income." The audit report had offset the $249. against the investment income.

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Order of Richard A. Berman, Director, Office of Health Systems Management

"#4: Whether legal expenses of $2,503. is allowable." The audit report had isallowed the $2.503.

"#5: Whether office expenses of $7,408. is allowable." The audit report had disallowed $3,418. of promotional advertising and capitalized $3,990. of movable equipment rather than expensing it.

"#6: Whether $228. of miscellaneous expense is allowable." The audit report had disallowed the $228.

"#7: Whether $722. of phone calls is allowable." The audit report had disallowed the $722.

"#8: Whether conference expenses of $1,632. is allowable." The audit report had disallowed the $1,632.

"#10: Whether kitchen suppplies of $3,134. should have been expensed." The audit report capitalized the $3,134.

"#11: Whether $6,140. of laundry expense is allowable." The audit report had disallowed the $6,140.

"#12: Whether $36,282. in repair and maintenance are allowable." The audit report treated it as follows:

> Costs (as per schedule H of the audit report) that should have been capitalized rather than expensed $10,435.
>
> Non-moveable equipment that should have been capitalized rather than expensed $19,988.
>
> Moveable equipment that should have been capitalized rather than expensed $1,765.

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Order of Richard A. Berman, Director, Office of Health Systems Management

1972 costs that were prepaid and hence disallowed upon audit $2,530.

Costs for which there had been an insurance recovery $220.

Personal expenses of the operators $1,344.

"#13: Whether $805. as light and power items are allowable as expense items." The audit report disallowed $447. and capitalized $358., rather than expensing it.

"#14: Whether $265. of personal expenses is allowable." The audit report had disallowed the $265.

"#15: Whether $7,724. in building supplies is allowable as expense items." The audit report capitalized the $5,843., rather than expensing it, and disallowed $1,881. of personal expenses of the operator.

"#16: Whether $4,270. of gardening expenses are allowable as expense items." The audit report capitalized $4,000. rather than expensing it, and disallowed $270. of personal expenses of the operator.

"#17: Whether $13,402. in medical supplies are allowable as expense items." The audit report capitalized $11,628. of moveable equipment rather than expensing it, and disallowed the following items:

Unallowable charges for prescription drugs	$1,216.
Unallowable charges for lab fees and doctors	141.
Personal expenses of operator	417.
Total	$1,774.

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"#18: Whether $7,713. of activities program is allowable as expense items." The audit report capitalized $3,494. rather than expensing it, and disallowed $4,219.

"#21: Whether $96,222. of the moveable equipment component of the basis for return on equity is allowable." The audit report had disallowed the net effect of $96,222. as part of the basis for return on equity.

CONCLUSION

In view of the concession by Split Rock Nursing Home and no evidence having been submitted by the facility, the audit adjustments should be sustained.

Now, upon the reading and filing of the Notice of Hearing and the Hearing Officer's findings of fact, opinion and recommendation, the Director

HEREBY ORDERS:

1. That in regard to Issue number 1 from the Notice of Hearing, administrative salaries shall be reduced by $17,780.00.

2. That in regard to Issue number 2 from the Notice of Hearing, payments to private duty nurses in the amount of $2,417.00 shall be disallowed.

3. That in regard to Issue number 9 from the Notice of Hearing, allowable automobile expenses shall be reduced by $6,019.00.

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4. That in regard to Issue number 19 from the Notice of Hearing, petty cash expenditures shall be reduced by $8,700.00.

5. That in regard to Issue number 20 from the Notice of Hearing, the working capital shall be reduced by $270,540.00.

6. That in regard to Issue number 22, the imputed rental allowance shall be that set upon audit of $313,407.00.

7. That the incentive allowance originally granted shall not be allowed.

8. That basing the reimbursement rate on 1971 costs was proper.

9. That in regard to Issue number 3, $249.00 of interest shall be offset against investment income.

10. That in regard to Issue number 4, $2,503.00 of legal expenses shall be disallowed.

11. That in regard to Issue number 5, $3,418.00 of promotional advertising shall be disallowed, and $3,990.00 of moveable equipment expense shall be capitalized rather than expensed.

12. That in regard to Issue number 6, $228.00 of miscellaneous expense shall be disallowed.

13. That in regard to Issue number 7, $722.00 of phone expense shall be disallowed.

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14. That in regard to Issue number 8, $1,632.00 of conference expenses shall be disallowed.

15. That in regard to Issue number 10, $3,134.00 of kitchen supplies shall be capitalized, not expensed.

16. That in regard to Issue number 11, $6,140.00 of laundry expense shall be disallowed.

17. That in regard to Issue number 12, $36,282.00 in repairs and maintenance shall be treated as follows:

Costs that shall be capitalized rather than expensed $10,435.00.

Non-moveable equipment that shall be capitalized rather than expensed $19,988.00.

Moveable equipment that shall be capitalized rather than expensed $1,765.00.

1972 costs that were prepaid and hence are disallowed $2,530.00.

Costs for which there had been an insurance recovery and hence are disallowed $220.00.

Personal expenses of the operator shall be disallowed $1,344.00.

18. That in regard to Issue number 13, $358.00 of light and power items shall be capitalized, not expensed; and $447.00 is disallowed.

19. That in regard to Issue number 14, $265.00 of personal expenses shall be disallowed.

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20. That in regard to Issue number 15, $5,843.00 in building supplies shall be capitalized, not expensed; and $1,881.00 of personal expenses of the operator shall be disallowed.

21. That in regard to Issue number 16, $4,000.00 of gardening expenses shall be capitalized rather than expensed; and $270.00 of personal expenses shall be disallowed.

22. That in regard to Issue number 17, $11,628.00 of medical supplies shall be capitalized, not expensed; and $1,774.00 of various items referred to in the findings of fact shall be disallowed.

23. That in regard to Issue number 18, $3,494.00 of activities program shall be capitalized, not expensed; and $4,219.00 shall be disallowed.

24. That in regard to Issue number 21, $96,222.00 of the moveable equipment shall not be a component of the basis for a return on equity.

It is further ORDERED:

That a rate of reimbursement be promulgated reflecting readjustments as per this Order.

Dated: Albany, New York
January 30, 1980

/s/ RICHARD A. BERMAN

Richard A. Berman, Director
Office of Health Systems Management

APPENDIX E

Report of Francis P. Mulderry, Hearing Officer and Commissioner's Representative

STATE OF NEW YORK

DEPARTMENT OF HEALTH

OFFICE OF HEALTH SYSTEMS MANAGEMENT

IN THE MATTER

OF

SPLIT ROCK NURSING HOME

Request pursuant to Section 86-2.7, Chapter II of the Code of Rules and Regulations of the State of New York

To: THE HON. DAVID AXELROD, M.D
Commissioner of Health of the State of New York;
and RICHARD A. BERMAN, Director of the Office
of Health Systems Management.

The Notice of Hearing dated August 25, 1978 with the statement of issues was duly served: the undersigned FRANCIS P. MULDERRY, ESQ., was duly designated as Hearing Officer; hearings were conducted on September 28, November 20 and December 5, 1978 in the Hearing Room of the Department of Health, Empire State Plaza, Albany, New York and Two World Trade Center, New York, New York;

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the Department of Health appeared by Jerome T. Levy, Esq., Counsel, by Harriet Katz, Esq. and Steven U. Teitelbaum, Esq. of Counsel, Respondent appearing by Hoffinger, Friedland & Roth, Robert Z. Dobrish, Esq. of Counsel, and transcripts of the proceedings were made and exhibits received in evidence.

Now, after due deliberation and consideration of the proceedings, the Hearing Officer does hereby submit his report including Issues, Findings of Fact, Opinion and Recommendations as follows:

BACKGROUND

The New York State Department of Health completed an audit report of the Split Rock Nursing Home for the period January 1, 1971 through December 31, 1971 with respect to reimbursement for Medicaid.

As a result of this audit report dated November 11, 1975 (Department Exhibit # 5), some adjustments were made by Department auditors, thus reducing the Medicaid reimbursement for those years.

The operators of Split Rock Nursing Home protested some of the adjustments made in the audit. The protest was reviewed by the Department's Rate Review Board after which certain items remain in dispute.

Pursuant to Section 2803 of the Public Health Law of the State of New York and Section 86-2.7, Chapter II of the Code of Rules and Regulations of the State of New

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York, a hearing was held on the dates as herein stated to hear testimony with respect to the issues in dispute.

At the hearing of September 28, 1978, counsel for Split Rock Nursing Home requested that the issues of whether the 1971 costs as audited should form the basis for the rate in subsequent years, and whether an incentive award granted to the facility by the Department of Health should be eliminated. Counsel for the Department opposed this motion and as a result both parties stipulated to adjourn in order to obtain a court determination.

Justice Edward Conway of the New York State Supreme Court granted that counsel's request that the two additional issues should be heard and a decision rendered by the Hearing Officer on these issues as well as the audit issues.

Split Rock Nursing Home elected not to contest all of the items contained in the audit report which were originally protested leaving six items in contention which will be listed below by the number by which they were identified in the statement of issues attached to Exhibit # 2.

ISSUE I

Whether $17,780 in administrative salaries is allowable.

FINDINGS OF FACT

Marvin E. Kern is a Medical Facilities Auditor employed by the New York State Department of Health and has been employed as an auditor by the Department for approximately 12 years. (Min. 11/20/78, p. 137)

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Mr. Kern testified that the salary for Mr. William Brian had been charged partially to "other administrative salaries" because Mr. Brian was a nurse. (Min. 11/20/78, pp 143-4)

Mr. Kern's observations and discussions with Mr. Brian and the Nursing Home operator led him to a determination that Mr. Brian was functioning primarily as an assistant administrator. (Min. 11/20/78, pp 143-4-5-6)

The HE-2P filed by Split Rock Nursing Home listed William Brian as an assistant administrator. (Min. 11/20/78, p. 171)

Sidney Feld, present accountant for Split Rock Nursing Home testified that he was not familiar with Mr. Brian's duties or the allocation of his salary.

The transfer of Mr. Brian's salary to administrator's salaries had the effect of exceeding the ceiling for that item placed upon the facility by the Health Department.

OPINION

The audit adjustment with respect to the disallowance of the administrative salaries should be sustained.

ISSUE II

Whether $2,417 as payments to private-duty nurses is allowable.

FINDINGS OF FACT

The Health Insurance Manual-15 specifically precludes reimbursement of private-duty nurses, according to testimony of Mr. Kern. (Min. 11/20/78, p. 149)

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Mr. Kern, in making his audit report, noticed a disbursement category entitled "Non-ambulatory services". When he questioned the accountant and the operator, he was advised these sums were paid to private-duty nurses. (Min. 11/20/78, pp. 150-1)

Mr. Feld, Split Rock Nursing Home's accountant did not look at the books and records with respect to private-duty nurses and testified to his agreement that private-duty nurse payments are not reimbursable. (Min. 12/5/78, p. 231)

Mr. Kern's audit disallowed the sum of $2,417 in payments to private duty-nurses. (Exhibit # 5)

Opinion

The Nursing Home's testimony does not give the Hearing Officer any reason to do other than sustain the audit adjustment disallowing the $2,417 in payments.

Issue IX

Whether automobile expenses totaling $7,606 are allowable.

Findings of Fact

Mr. Kern, Department's auditor made an estimate of usage of automobiles by Split Rock Nursing Home based upon his operations while at the facility for a 60-day period. (Min. 11/20/78 pp 152-3)

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Mr. Kern stated that only auto expenses related to patient care are reimbursable according to regulations and HIM-15. (Min. 11/20/78, pp 156-7)

The allowance upon audit of 15 cents per mile was based upon the Internal Revenue Code at that time. (Min. 11/20/78, p. 157)

Split Rock Nursing Home had charged a total of $10,306 related to the use of automobiles, listed under various headings, such as medical expenses, kitchen supplies, etc. (Min. 11/20/78, p. 157)

In his audit, Mr. Kern estimated automobile usage for patient care based upon his operations and experience to be 1800 miles and allowed 15 cents per mile, for a total of $2,700, testifying that he was not provided with itemized expenses related to automobile usage.

Split Rock Nursing Home offered a detailed analysis of some of the automobile expenses which their accountant, Mr. Feld testified indicated a total of $4,287 in automobile expenses. (Exhibit G)

OPINION

The original amount of $10,306 was not documented by the Nursing Home. In the absence of documentation, Mr. Kern made an estimate from his operations over a short period of time. In view of the fact, Split Rock Nursing Home submitted some detail at the hearing, the Hearing Officer accepts this amount, thus the disallowance on audit should be $6,019.

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Issue XIX

Whether $8,700 of petty cash expenditures should be allowable.

Findings of Fact

Mr. Kern's testimony was that Split Rock Nursing Home lacked documentation with respect to petty cash expenses. (Min. 11/20/78, pp 163, 169)

Further, it was stated by Mr. Kern that he discussed this matter with Mr. Newman, the previous accountant for the Nursing Home, and Mr. Feld, the current accountant, all of whom participated in a discussion which arrived at the amount of petty cash to be disallowed. (Min. 11/20/78, p. 163)

This was further discussed among the same parties plus the operator at the exit conference. (Min. 11/20/78, p. 165)

Split Rock Nursing Home offered no testimony which would lead the Hearing Officer to be swayed from Mr. Kern's determination.

Opinion

The audit adjustment with respect to the disallowance of petty cash should be sustained.

Issue XX

Whether $270,540 of working capital is allowable.

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Findings of Fact

Disallowance on this point was made for three different reasons (See Exhibit # 5):

(a) Municipal bonds of the owners were a personal asset and thus not capital of the facility, totaling $236,198.

(b) Prepaid interest was adjusted to eliminate capital return on the non-current amount, a total of $28,532.

(c) Patients' personal monies were removed from return on capital since they should be a current liability, in the sum of $5,816.

Mr. Feld testified that it would not be proper to include personal bonds of the owner of a facility as working capital. (Min. 12/5/78, p. 232)

Further testimony elicited from Mr. Feld states that the patient monies were not capital of the facility. (Min. 12/5/78, p. 234)

At the hearing, both parties were silent with respect to prepaid interest. Mr. Kern's affidavit dated June 22, 1979, which was permitted to become part of the record due to misunderstanding at the hearing as to which items were uncontested, stated that interest from the bonds in question was not reflected in income of the Nursing Home, and the investment was not used as working capital.

Opinion

Overall testimony from both parties leads the Hearing Officer to the conclusion that the audit changes by the Health Department were proper as to the municipal bonds

and patients' personal monies, and there being nothing in the record to refute the decision on the prepaid interest, the adjustment with respect to reduction of working capital reimbursement is sustained.

Issue XXII

Whether $345,600 should be the imputed rental allowance rather than the $313,407 shown on the rate sheet.

Findings of Fact

During 1971, Split Rock Nursing Home was in operation for 331 days of the year. (Min. 12/5/78, p. 236)

Estelle Wall is a Fiscal Analyst employed by the New York State Department of Health who has served in that capacity for thirteen years. (Min. 11/20/78, pp 44-5)

Ms. Wall testified that imputed rental was calculated based upon the days of operation in 1971, which were 331. (Min. 11/20/78, p. 57)

The amount arrived at was a rate per day and would then be used in future years for the full term of the year, or 365 days at that rate. (Min. 11/20/78, pp 57-8)

Ms. Wall stated that this method of calculation, had it been made for a full 365 day year would have resulted in dividing by a larger number and the result would quite likely been almost the same. (Min. 11/20/78, p. 59)

Opinion

The Hearing Officer concedes that this is a very difficult point. However, the entire testimony indicates that the

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Report of Francis P. Mulderry, Hearing Officer and Commissioner's Representative

Health Department, in its audit, calculated imputed rental on a daily rate based upon the actual days of operation in 1971. Then this daily rate was used subsequently on a 365 day per year basis. Department's audit report in this respect should be sustained.

Incentive Allowance

It was the practise of the Health Department to grant an incentive allowance to those Nursing Homes whose rates were below the group average and which were being operated without significant operational deficiencies.

Findings of Fact

Ms. Wall of the Health Department testified that an incentive allowance is granted to facilities operating without deficiencies at a cost below group average. (Min. 11/20/78, pp 87-8)

Terry Opela is a fiscal analyst employed by the New York State Department of Health and has been so employed for some 5½ years. (Min. 12/5/78, pp 177-8)

Mr. Opela stated that incentive allowances would be forfeited if the facility was placed on the "significant operating deficiency list". (Min. 12/5/78, pp 192-3)

The Hearing Officer deduces that both parties concede Split Rock Nursing Home was originally granted an incentive allowance.

Mr. Kern, Department's witness stated that elimination of incentive allowances is not an audit function. (Min. 11/20/78, p. 166)

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Ms. Wall testified that there were no regulations with respect to removal of an incentive allowance based upon audit, but she indicated a memorandum exists which says an incentive allowance may be removed if an audit shows personal expenses were included in the report. (Min. 11/20/78, pp 47-8)

Opinion

No Health Department regulations were in effect with respect to removal of incentive allowances other than for operating deficiencies. Internal correspondence referred to on this point did not exist during the year in question at this hearing.

Therefore, it is the feeling of the Hearing Officer that removal of the incentive allowance was improper and it should be restored.

Issue

Should 1971 costs form the basis for the rate for ensuing years.

Findings of Fact

Split Rock Nursing Home was a new entity without adequate cost experience, which opened in early 1971 and was open 331 days in that year. (Min. 12/5/78, p. 236)

The facility submitted an HE-2P form at the conclusion of 1971 showing eleven months costs on a form designed for twelve months costs.

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For 1971, Split Rock Nursing Home was slightly less than 90% capacity; i.e., 89.2% according to testimony of Mr. Wall. (Min. 11/20/78, p. 121)

Under the rules in effect in 1971, new facilities without adequate cost experience were reimbursed at the lesser of group average or actual cost as determined by cost experience—6 months at 90%. The reason for this is to avoid windfalls to the facility by virtue of fixed expenses divided by an inadequate number of patient days.

OPINION

In order to control costs, the Health Department policy is to reimburse at the lower of group average cost or actual cost where a facility's past experience is inadequate.

Where there is less than 90% capacity and fewer than twelve months experience, the facility actually receives a benefit since ceilings are based on a full year and reimbursement is arrived at by dividing cost by patient days; i.e.,

A. Rental ceiling = X for twelve months.

B. If the facility pays rent for only ten months it has a benefit over the ceiling of approximately 16.7%.

To use the group average for reimbursement would create an incentive to increase costs rather than reduce them, therefore, the Health Department's decision to use 1971 costs as a basis for rates should be sustained.

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RECOMMENDATIONS

Based upon the above opinions, I recommend the following:

ISSUE I:—Administrative salaries should be reduced by $17,780.00

ISSUE II:—Payments to private duty nurses in the amount of $2,417.00 should be disallowed.

ISSUE IX:—Allowable automobile expenses should be reduced by $6,019.00

ISSUE XIX:—Petty cash expenditures should be reduced by $8,700.00.

ISSUE XX:—Working capital should be reduced by $270,540.00

ISSUE XXII:—The imputed rental allowance should be that set on audit.

INCENTIVE ALLOWANCE ISSUE:—The incentive allowance originally granted should be restored.

RATE BASIS ISSUE:—Basing the rate on 1971 costs was proper.

DATED: Albany, New York
July 27, 1979

Respectfully submitted,

/s/ FRANCIS P. MULDERRY

FRANCIS P. MULDERRY
Hearing Officer and
Commissioner's Representative

Office - Supreme Court, U.S.
FILED
NOV 8 1982
ALEXANDER L. STEVAS,
CLERK

No. 82-467

IN THE

Supreme Court of the United States

October Term, 1982

SPLIT ROCK NURSING HOME,

Petitioner,

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Management,

Respondents.

Respondents' Brief in Opposition to Petition for a Writ of Certiorari

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Counterstatement of Questions Presented.

1. Whether the question presented by petitioners was raised in the New York Courts.

2. Whether the due process clause of the Fourteenth Amendment is violated where, as here, a State administrative agency applies broad regulatory language to a specific factual situation as it arises.

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IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1982

No. 82-467

SPLIT ROCK NURSING HOME,

Petitioner,

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Management,

Respondents.

Respondents' Brief in Opposition to Petition for a Writ of Certiorari.

Preliminary.

Petitioner offers but one reason why certiorari is warranted in this case which is premised upon a claim that "New York acted unconstitutionally when it seized [Medicaid] money paid to petitioner years earlier by giving retroactive effect to a new interpretation of its own [incentive allowance] regulation" (Pet, p 6). Our position as to

this is that there was no "seizure" nor was there a retroactive change in the interpretation of the incentive allowance regulation. Respondents merely applied broad regulatory language to a specific factual situation as it arose, i.e., the discovery, upon audit, that petitioner's return on equity had been enhanced by improperly using patients' personal monies to inflate its equity by including such monies as working capital.

New York Regulation Involved.

10 Official Compilation Codes, Rules and Regulations of the State of New York.

> "86.31 Incentive allowance; proprietary nursing homes. Within the rate of payment for proprietary nursing homes, an amount may be included as an allowable cost which is equal to a percentage established by the commissioner to represent a sharing in the amount by which the total costs of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average* of the costs of these services for the group. In instances where the latest survey disclosed significant deficiencies in the operation of a facility, the incentive allowance will not be available." (Hereinafter 10 NYCRR § 86.31.)

The regulation was repealed October 14, 1975.

Statement of the Case.

Petitioner operates a proprietary nursing home in Bronx, New York and accepts patients whose cost of care is paid pursuant to the State's program of "Medical Assistance for Needy Persons" ("Medicaid", New York

*The section was added August 10, 1970, and amended August 17, 1971, to delete the word "ceiling" following "weighted average." The Petitioner has set out the regulation as first filed.

Social Services Law, §§ 363 *et seq.*; 42 USC Title XIX, §§ 1396 *et seq.*). The amount which petitioner receives for furnishing such care (its Medicaid reimbursement rate) is established pursuant to New York Public Health Law, Article 28 and applicable regulations.* The "incentive allowance" had been granted to petitioner pursuant to 10 NYCRR § 86.31 for the rate period effective July 1, 1972 through December 31, 1972 and, after a change in the fiscal year, from January 1, 1973 to December 31, 1973. It was disallowed after a regular audit of the facility's initial year operating costs incurred in 1971.

An administrative hearing was held to review several items which had been disallowed including the incentive allowance. The Hearing Officer had concluded that the "removal of the incentive allowance was improper and it should be restored" (Pet, p 30a). The director of the Office of Health Systems Management of the State Department of Health overruled that conclusion in his January 30, 1980 order (Pet, pp 8a, *et seq.*). He carefully reviewed the testimony of departmental personnel (pp 10a, 11a, 12a) and the regulation itself, including its 1975 repeal. He noted that the testimony showed that one aspect of losing the incentive allowance would be forefeiture if a facility was placed on the "significant operating deficiency list" (Pet, pp 10a, 12a) and that:

> "* * * However, § 86.31 speaks of significant deficiencies in the operation of a nursing home, which would include a broader scope of activity.

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*Public Health Law, Article 28 regulations (which included § 86.31) are adopted and amended by the State Hospital Review and Planning Council, subject to the approval of the Commissioner of Health (Public Health Law, § 2803[2]).

> "In view of the Hearing Officer's finding of fact that in regard to Issue number 20 from the Notice of Hearing, that certain personal expenses of the operator and patients' personal monies were included in the working capital and hence the equity of the facility for reimbursement purposes, and upon audit disallowed, it is the Director's conclusion that the Respondent's action in so including them were significant deficiencies in the operation of the facility, as described in § 86.31. The use of patient monies to enhance one's return on equity by improperly using that money to inflate a nursing home's equity is not a proper use of the patient's personal monies. * * *" (Pet, p 12a)

He directed "[t]hat a rate of reimbursement be promulgated reflecting readjustments as per this Order" (Pet, p 19a).

The New York Appellate Division, Third Department, the court of first instance review, after stating that an agency interpretation of its own regulations is entitled to great weight and will be upheld if not irrational or unreasonable, rejected respondent's construction of the regulation as "not supported by any administrative precedent, written or otherwise" (85 AD2d 808, 809; 445 NYS2d 638 [3d Dept, 1981]).

The New York Court of Appeals reversed and reinstated the order of the Director of Health Systems Management as it pertains to petitioner's incentive allowance. It held that he "* * * did not act arbitrarily or unreasonably in this case in disallowing petitioner's incentive allowance for the years at issue. Accordingly, the determination of the Director must be sustained (*Matter of Cortlandt Nursing*

Care Center v. Whalen, 46 N.Y.2d 979)".* (56 NY2d 932, at 934; 453 NYS2d 680 [1982].)

Petitioner does not argue that it did not engage in an improper practice. Rather it asks this Court to raise a constitutional barrier between it and the application of the broad language of 10 NYCRR § 86.31 against it. This Court, we urge, should reject that invitation.

Reasons for Denying Certiorari.

A.

This proceeding was initiated in State Supreme Court pursuant to New York CPLR Article 78 to review the January 30, 1980 order which petitioner alleged to be, *inter alia*, arbitrary and capricious as well as an abuse of discretion. Its papers do not contain a claim of denial of due process of law or any constitutional claim. In its main brief in the New York Appellate Division, Third Department, it was stated, without argument or citation of authority, that:

> "In sum, the Health Department's determination to revoke Split Rock's incentive award retroactively is without a factual or legal basis and violates due process.* * *" (App. p. 16a).**

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*In *Cortlandt Nursing Care Center*, the New York Court of Appeals stated (46 NY2d at 980):

> "* * * the commissioner's interpretation of a regulation is 'controlling and will not be disturbed in the absence of weighty reasons.' (*Matter of Sigety v. Ingraham*, 29 NY2d 110, 114.) Unless the commissioner's determination is arbitrary and capricious, it must be sustained. (*Severino v. Ingraham*, 44 NY2d 763, 764.)"

**We have printed petitioner's Brief and Reply Brief at the New York Appellate Division as an Appendix.

Neither the Appellate Division nor the Court of Appeals, which considered the matter summarily, spoke to due process. Petitioner's argument in State Court does not disclose whether his claim is grounded on Federal due process provisions or on the due process provisions of the Constitution of the State of New York (Article I, § 6. "* * * No person shall be deprived of life, liberty or property without due process of law"). Nor has petititioner obtained a certificate from the New York Court of Appeals as to which, if either, provision was considered (see *Dept. of Mental Hygiene v. Kirchner,* 380 US 194 [1965]). In these circumstances we urge that the Court lacks jurisdiction to hear and determine this matter (see *Stembridge v. Georgia,* 343 US 541 at 547 [1952]; *Durley v. Mayo,* 351 US 277 at 281 [1956] that "it must affirmatively appear from the record that the federal question was presented to the highest court of the State having jurisdiction").

B.

In holding that the Director of the Office of Health Systems Management did not act arbitrarily or unreasonably in this case in disallowing petitioner's incentive allowance for the years at issue, the New York Court of Appeals cited as authority its decision in *Matter of Cortlandt Nursing Care Center v. Whalen,* 46 NY2d 979 (1979). In that case, the Court held that the State Commissioner's interpretation of a regulation is "controlling and will not be disturbed in the absence of weighty reasons" unless the determination is arbitrary and capricious.

The New York Court of Appeals in its June 17, 1982 decision in the case at bar took care to limit its holding to "this case".* The Court did not characterize the State

*In which it had been discovered that petitioner's return on equity had been enhanced by improperly using patients' personal monies to inflate its equity by including such monies as working capital.

Commissioner's interpretation as a "new" interpretation, as petitioner suggests, or as an old interpretation. The Court, we urge, simply agreed with the State Commissioner, acting through his designee, that the broad regulatory language of section 86.31 applied to the specific factual situation presented by this case.

The statutory predicate to the State Commissioner's establishment of Medicaid reimbursement rates is found in New York Public Health Law, § 2807(3).* Pursuant to its terms the State Commissioner of Health, as to Medicaid reimbursement, must certify to the State Director of the Budget that the proposed rate schedules for payment of hospital and health related service "are reasonably related to the costs of efficient production of such service" (see *Blum v. Yaretsky*, ____ US ____, 102 S Ct 2777 at 2781 [1982]). This Court has recognized "* * * The sound principle of according deference * * * where the relevant statutory language is unclear or susceptible of differing interpretations" (*Shea v. Vialpando*, 416 US 251 at 262, n 11 [1974]). The New York Public Health Law, Article 28 statutory complex under which the State Commissioner functions in establishing Medicaid reimbursement rates is such a statute. We thus urge that this is precisely the type of case in which this Court would afford great weight to the State Commissioner's construction of his own regulations (see, e.g. *Red Lion Broadcasting Co. v. FCC*, 395 US 367 [1969], *Udall v. Tallman*, 380 US 1 [1964]). The Court has most recently reiterated that proposition in *Blum v. Bacon*, ____ US ____, 102 S Ct 2355 at 2361 (1982) and in *Schweiker v. Hogan*, ____ US ____, 102 S Ct 2597 at 2609 (1982).

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*New York Laws of 1969, ch 957, § 4, effective May 26, 1969.

Removal of the incentive award after audit* was based upon the Hearing Officer's finding "that certain personal expenses of the operator and patients' personal monies were included in the working capital and hence the equity of the facility for reimbursement purposes" (Pet, p 12a). The Director of the Office of Health Systems Management concluded that "Respondents' [petitioners here] action [*sic*] in so including them were significant deficiencies in the operation of the facility, as described in § 86.31. The use of patient monies to enhance one's return on equity by improperly using that money to inflate a nursing home's equity is not a proper use of the patient's personal monies" *(idem.)*. What the State Commissioner held was that the nursing home was not entitled to an incentive award because it had engaged in an improper practice which was a significant deficiency in the operation of the facility. We urge that that holding was an altogether reasonable and rational interpretation by the Commissioner (through the Director, his designee) of his own regulation.

The decision and order of the New York Appellate Division which petitioner seeks to have reinstated seems to have been based, in large part, upon testimony of departmental employees at the administrative hearing. They, however, were not in policy-making positions and were not competent to testify concerning the policy of the Commissioner of Health. Indeed their testimony showed only that if a facility had been placed on a serious operating deficiencies list it would lose its incentive allowance. We

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*Medicaid rates are fixed prospectively subject to periodic post-audit which can result in upward or downward adjustment of the original rate (see, e.g., *Solnick v. Whalen*, 49 NY2d 224, 425 NYS2d 68 [1980]; *Matter of Demisay v. Axelrod*, 87 AD2d 667, 448 NYS2d 834 [New York Appellate Division, 3d Dept. 1982], mot for lv to app den ____ NY2d ____ [1982]).

find no testimony, however, which would demonstrate that facilities that included patients' personal monies in working capital would be granted the allowance. The Commissioner's application of the regulation is fully consistent with its language. The Court need not and should not go behind its plain language.

The only issue in this case is the degree of deference which should be accorded to the interpretation and application of section 86.13 as manifested by the Director's January 30, 1980 order. The due process claim, mentioned by petitioner below as an aside, simply does not arise.

The "incentive award" had to be earned by a facility. That such an award has been denied to a facility that has overstated its equity account, as has petitioner, certainly does not shock one's sense of justice and fair play. 10 NYCRR § 86.31 has, we urge, been reasonably interpreted here so that petitioner will not be rewarded for its actions.

Finally, we again note that section 86.31 was repealed in 1975. A decision of this Court on the merits would thus have only limited significance.

CONCLUSION.

For the foregoing reasons, the petition for a writ of certiorari should be denied.

Dated: Albany, New York
October 26th, 1982

Respectfully submitted,

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APPENDIX A.—Petitioner's Brief.

Argued by
DAVID B. BERNFELD
(30 MINUTES REQUESTED)

NEW YORK SUPREME COURT

APPELLATE DIVISION—THIRD DEPARTMENT.

IN THE MATTER
of
The Application of SPLIT ROCK NURSING HOME,
Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Management,

Respondents.

PETITIONER'S BRIEF

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Index No. 80-517

PETITIONER'S BRIEF

Preliminary Statement.

Split Rock Nursing Home petitions for a judgment pursuant to CPLR Article 78 annulling, vacating and setting

aside an order issued by the New York State Department of Health, dated January 30, 1980, after an administrative hearing, sustaining a reduction in the Medicaid reimbursement received by Split Rock Nursing Home.

These proceedings were transferred to this Court on May 14, 1980, by order of the Supreme Court, Albany County (Klein, J.) pursuant to CPLR 7804 (g).

Introduction.

Background.

Split Rock Nursing Home (petitioner) is a private proprietary nursing home located in the Bronx, New York. The expenses incurred in caring for Medicaid-eligible patients are reimbursed in accordance with federal and state statutes and rules promulgated by the New York State Department of Health (see generally, Title XIX of the Federal Social Security Act, 42 USC 1396 *et seq.*; Public Health Law §2807; Social Services Law §§ 363-368; 10 N.Y.C.R.R. Part 86).

Although the facility opened in 1971, its books and records for 1971 were not audited by the Health Department until 1974. Thereafter, based on that belated audit and without any prior hearing, the Health Department seized approximately $350,000 from the facility by withholding that amount from the reimbursement the home was entitled to receive in 1978.

Petitioner protested the determination which purportedly formed the basis for the seizure and requested a hearing. The protest and the request for a hearing were both summarily denied by the Department. A hearing was ultimately

held, however, pursuant to a court order obtained by petitioner. The hearing officer concluded that petitioner was entitled to approximately $90,000 of the amount in contention, but the Department refused to return even that, insisting on retaining all it had seized.

Issues raised.

Although there were numerous audit adjustments at issue in the administrative hearing, petitioner seeks review of only two issues:

> (a) approximately $90,000 in "incentive allowance" (which the hearing officer rules should have been returned to petitioner); and
>
> (b) whether the petitioner was entitled to reimbursement based on "group average" rather than "actual cost" (the Department insisted on "actual cost" to the petitioner's detriment in the amount of approximately $250,000).

The incentive allowance was established by the Health Department as part of a program designed to encourage cost savings; facilities which operate at a cost lower than the average for facilities of the same size in the same area receive a portion of that cost-savings as an incentive. Facilities are thus encouraged to avoid passing through excess costs to the State for reimbursement, thereby benefiting the State—as well as the individual facility.

Since Split Rock was a cost-efficient facility, it received an incentive allowance of approximately $90,000 in 1972. Nevertheless, many years later, the Department arbitrarily took back that allowance and has refused to return it—despite the finding of its own hearing officer.

The second issue—whether the facility was entitled to be reimbursed during 1972 and 1973 according to "group average" instead of "actual cost"—involves a determination of the proper "cost" basis for reimbursing newly opened facilities which have limited or inadequate historical cost experience. In order to insure that future reimbursement was not based on incomplete and inadequate cost data statistics, until a facility submitted a cost report covering a period of six consecutive months where there had been an occupancy rate of at least 90%, the Health Department required that prospective reimbursement be based on the average costs incurred by comparable nursing homes (the "group average") rather than on the facility's actual costs.

If 90% occupancy was maintained for six consecutive months during the first year of operation, the facility had the option to switch away from "group average cost" to "actual cost" by filing a six month cost report showing the requisite occupancy rate. The option of making that switch belonged to the facility; it was not an obligation.

For the year 1971, the year it opened, Split Rock had an occupancy rate of less than 90%. Moreover, it never filed a six month cost report. It did submit a report at the end of 1971 covering all costs incurred throughout 1971, which revealed an 89.2% occupancy for the reporting period. Accordingly, "group average cost" for 1971 rather than "actual cost" should have been used for prospective reimbursement purposes for 1972 and 1973. The Department, however, utilized actual costs for 1971—which were lower than the group average—costing the facility more than $250,000.

The Evidence at the Hearing.

Incentive allowance.

Ms. Estelle Wall, Chief Health Care Fiscal Analyst for the Department of Health, was in charge of the unit that established Medicaid reimbursement rates from 1970 through 1974 (Wall: 97-98).* Mr. Terry Opela was responsible for examining reports submitted by nursing homes to the Department of Health and for applying certain ceilings and limitations to arrive at the reimbursement rate (Opela: 232; Wall: 102).

Ms. Wall and Mr. Opela explained that nursing homes were given an "incentive"—an additional sum of money or other increased amount of reimbursement—if they operated below the group average and without significant operating deficiencies (Wall: 140-41; Opela: 246). Group average was determined by grouping nursing homes according to size, geographical area and other factors, and arriving at an average cost for comparable services incurred by nursing homes in the group (Opela: 235-36).

The Significant Operating Deficiency List (S.O.D. list) was made up of homes which surveyors concluded, on the basis of operational inspections, were operating deficiently. The S.O.D. list was prepared by surveyors—not auditors (Opela: 247). Being on the S.O.D. list was the sole basis for depriving a home of the "incentive" (Wall: 141; Opela: 246-47).

Mr. Marvin Kern, Chief Auditor for the Health Department (Kern: 190), confirmed that the official regulations did not authorize elimination of the incentive as a result of

*References are to the Record on Appeal.

audit findings (Kern: 219). According to Ms. Wall the incentive could be eliminated "if the audit shows that there were personal expenses in the [HE-2P] report" (Wall: 101) in accordance with "internal correspondence [which] did not exist during the year in question . . ." (28; see 143-144). But, Mr. Kern could not recall a single instance in which an incentive was disallowed on the basis of an audit (Kern: 219).

Group average versus 1971 costs.

Nursing homes are reimbursed for the services provided to Medicaid patients according to rules established by the Department of Health. The reimbursement is essentially cost-based (Wall: 99-102). Every facility must submit an HE-2P report, setting forth the income received and expenses incurred during the preceding calendar year (Wall: 102, 181). The rates are prospective: costs incurred in or attributable to one year are used to determine the reimbursement rate in subsequent years (Wall: 99, 108).

Since newly opened nursing homes have no history of costs to utilize in setting the rate, Health Department regulations provided that new facilities were to be reimbursed on the basis of "group average" (Wall: 107-108, 125, 167; Opela: 235). However, if a new nursing home had ninety percent or more of its beds occupied for six consecutive months, it had the option of switching its rate to actual costs rather than staying with the group average, depending upon which was more favorable to the facility. The facility made that election by filing a six month cost reporting form which established the necessary occupancy rate for the requisite time periods and by submitting financials (income statements and balance sheets) which were certified by an independent certified public accountant (Wall: 107-108, 126, 128, 170, 186-88; Opela: 236, 238.)

Mr. Sidney Feld, a certified public accountant specializing in Medicaid reimbursement (Feld: 253-54), testified that costs incurred by a facility during its first year were generally "significantly less" than the costs it incurred during subsequent years (Feld: 258-60). That is why first year costs were not used by the Department to determine future reimbursement; group average was used unless the nursing home elected to utilize actual costs (Feld: 257). In short, it was contemplated that new facilities would receive not less than group average rates and might receive higher reimbursement if its actual costs exceeded that average (Feld: 258-259).

Mr. Feld testified that the HE-2P filed by the facility revealed an occupancy rate of less than 90% for the reporting period (Feld: 265).

POINT I.

Split Rock Nursing Home was entitled to an incentive award.

Split Rock Nursing Home qualified for and received an incentive allowance under Health Department regulations in effect in 1972 because the home's costs were below the average costs of other comparable facilities in its grouping. In 1978, the Health Department retroactively revoked that incentive award, claiming that Split Rock did not meet criteria set forth in secret and unofficial internal correspondence created some years later.

The hearing officer restored the incentive because,

> "It was the practice of the Health Department to grant an incentive allowance to those nursing

homes whose rates were below the group average and which are being operated without significant operational deficiencies.

* * * *

"No Health Department regulations were in effect with respect to removal of incentive allowances other than for operating deficiencies. Internal correspondence referred to on this point did not exist during the year in question at this hearing.

"Therefore, it is the feeling of the Hearing Officer that removal of the incentive allowance was improper and it should be restored" (27-28).

The Health Department, however, overruled its own hearing officer. The Department's action was improper and must be annulled.

The official Health Department regulations (10 N.Y.C.R.R. § 86.31) applicable in 1972 provided that nursing homes were entitled to an incentive award when:

"the total cost of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average ceiling of the costs of these services for the group. In instances where the latest survey disclosed significant deficiencies in the operation of a facility, the incentive allowance will not be available."

It is not disputed that Split Rock met the first criterion: its costs were lower than the group. And the evidence adduced at the hearing makes it clear that Split Rock met the

second criterion: it was not on the Department's Significant Operating Deficiency List.

At the hearing, Department employees explained that facilities with significant deficiencies were put on the S.O.D. list; those not on the list did not have significant operating deficiencies. The list was prepared by the local regional office based on survey reports—not on audits of books and records.

Thus, Ms. Estelle Wall, the Chief Health Care Fiscal Analyst for the Department, testified:

> "Q. O.K. Now, Mrs. Wall, are you familiar with the incentive allowance which is granted to certain nursing homes? A. Yes (140).
>
> • • • •
>
> Q. In other words, a facility would receive some sum of money or some increased factor into its rate or some increased amount into its rate if its costs were below a certain level and if it were operating in a certain manner? A. That's right.
>
> Q. And do you remember the term that was in the regulations with respect to when a facility would not be entitled to the incentive allowance? A. I think the term was significant operating deficiencies.
>
> Q. Do you know what a significant operating deficiency is? A. It's been identified by the program people and we accepted the homes that were given to us as having significant deficiencies.
>
> Q. Did you ever hear of anything called a significant operating deficiency list? A. Yes.

Q. And isn't it a fact that certain homes were placed on a significant operating deficiency list? A. Yes.

Q. And those homes that were placed on the significant operating deficiency list were the homes that would not be entitled to an incentive allowance? A. That's right.

And do you know who placed these facilities on the significant operating deficiency list? A. The regional health directors under their auspices.

Q. The health director of the local offices? A. Yes.

Q. Those are the health directors; those are the officers that do the surveys of the facilities? A. Yes" (141-142).

Mr. Terry Opela, a Fiscal Analyst for the Department, confirmed Ms. Wall's testimony:

"A. If a facility was to have operating deficiencies which we call our deficiencies list, then that facility would forfeit the right to any incentive for any particular rate year.

Q. Do you know how it was determined, how the factility was determined to have deficiencies? A. Just generally, our survey people would go in and they were the ones that found the deficiencies. Exactly what the deficiencies were they found, I don't know. All I know is I would get a list saying these homes had deficiencies.

Q. Are you familiar with the term "significant operating deficiency list"? A. Yes.

Q. Do you recollect if a facility would lose its incentive if it were on it? A. Yes.

Q. That was a list that was prepared by surveyors and local regional offices? A. That's right" (246-247).

Split Rock was not on the significant operating deficiency list, and the Department does not contend otherwise. Although the Department alludes to secret internal correspondence which purports to eliminate the incentive if the audit shows that there were personal expenses in the H.E.2P report, that internal correspondence cannot serve as a basis for revoking Split Rock's incentive.*

To begin with, that internal correspondence was not created until some years after the event in question (28; 143-144). It cannot be applied retroactively to govern reimbursement prior to that time.

The power to make administrative rules cannot be applied retroactively. The Court of Appeals explained this principle in *Hecht v. Monaghan,* 301 N.Y. 461 (1954):

> "When dealing with the public, the functions of an administrative agency fall into two broad categories, legislative and judicial. The Supreme Court of the United States drew the line of demarcation between those distinct functions in *Prentis v. Atlantic Coast Line,* 211 U.S. 210, 226, 29 S. Ct. 67, 69, 53 L.Ed. 150, where it said: 'A judicial inquiry investigates, declares, and enforces liabilities as they stand on present or past facts and under laws supposed already to exist. That is its purpose and end. Legislation on the other hand, looks to the future and changes existing conditions by a new rule, to be applied thereafter to all or some of those subject to its power." *Id* at 469.

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*That correspondence, although mentioned by Department witnesses, was not introduced into evidence.

Accord, Nash v. Brooks, 251 App. Div. 616 (3rd Dept. 1937); *Van Allen v. McCleary,* 211 N.Y.S. 2d 501, 506 (Sup. Ct. Nassau Co. 1961); *City of New York v. Malthie,* 53 N.Y.S. 2d 234, 245 (Sup. Ct. N.Y. Co. 1945); 2 N.Y. Jur 2d, Admin. Law § 32.

Under the rules in effect during 1972 it is undisputed that Split Rock qualified for the incentive allowance. The Health Department should not be permitted to ignore the 1972 rules and resort to internal correspondence created years later to govern what Split Rock was entitled to in 1972. We submit that the Department's attempt to impose new rules long after the event in question is arbitrary, capricious and violative of basic due process.

Furthermore, the internal correspondence violates the official regulations. The official regulations do not permit elimination of the incentive as a result of an audit. They refer only to a survey by surveyors dealing with whether there were significant operating deficiencies.

As Mr. Marvin Kern, the Chief Medical Facilities Auditor for the Department of Health, confirmed:

> "Q. Now, on audit have you ever had the occasion to disallow an incentive allowance? A. Not that I can recall in view of the fact that *that is not an audit function.* The application of the incentive allowance is a rate-setting function" (emphasis added) (219).

But even if it were proper to apply unpublished internal correspondence retroactively, and even if it did not violate official regulations, the correspondence would be without legal effect; to have legal effect, it would have to be filed

with the Department of State as an official rule or regulation to be published officially.

The New York State Constitution mandates that rules and regulations of state administrative agencies be filed with the Department of State. Rules and regulations which are not filed have no legal effect.

Article 4, Section 8 of the Constitution provides:

> "No rule or regulation made by any state department, board, bureau, officer, authority of commission, except such as relates to the organization or internal management of a state department, board, bureau, authority or commission shall be effective until it is filed in the office of the department of state. The legislature shall provide for the speedy publication of such rules and regulations, by appropriate laws."

The Constitutional filing and publication requirements cannot be avoided by labelling a document "internal correspondence":

> "We should not strive to read exceptions into the section or construe it so as to permit the official in charge of the bureau, commission or authority to avoid the necessity of filing by attaching the label "order" or "statement of policy" or some other term to what is essentially a rule or regulation. The spirit and design of the constitutional provision are best effectuated by requiring the administrator, if he wishes the rule and regulations of his agency or department to be effective, to file them no matter what label is assigned to them." *People v. Cull*, 10 N.Y.2d 123, 129 (1961).

Accord, People v. Widelitz, 39 M.2d 51; 239 N.Y.S.2d 707, 710 (Sup. Ct. Bronx Co. 1963).

In sum, the Health Department's determination to revoke Split Rock's incentive award retroactively is without a factual or legal basis and violates due process. Split Rock met the criteria for an incentive set forth in the official rules and regulations. The internal correspondence upon which the Health Department purportedly relied cannot be applied retroactively, is inconsistent with the official rules and their application and was never filed with the Department of State.

Under the circumstances, the conclusions of the hearing officer was correct: the "removal of the incentive allowance was improper and it should be restored" (28).

POINT II.

Split Rock's reimbursement rate should have been based on group average.

While reimbursement is ordinarily based on the costs incurred by a nursing home in prior years, a special rule applies for new nursing homes. For new homes, rates are based on the "group average"—the average cost of comparable services charged to nursing homes of the same size in the same area.

In the instant case, the Health Department has ignored that rule and insisted that Split Rock's rate be based on the costs it actually incurred during its first year, rather than group average. That determination should be annulled.

The Department's determination is based on an erroneous assumption—that the Department could elect to

base the rate on actual costs. This assumption was erroneous for two reasons: (a) the right to elect belonged to the nursing home, not the Department; and (b) Split Rock did not file a six month cost report, and therefore the Department did not have before it a factual predicate for establishing a cost based rate.

The testimony was clear; the right to elect cost based reimbursement was the nursing home's, not the Department's.

Ms. Wall testified:

> "Q. OK. Now why, if you know, was there the possibility for a facility to file a six-month report with 90 percent or more occupancy? A. The facilities filed if they felt that the rate given them based on the average for the group was not high enough. It was called putting them on a cost-based rate, so they filed their own costs in order to establish a cost-based rate" (106; see 170).

Mr. Opela's understanding of the rules was the same:

> "Q. What about during the initial year of operation? What would the rate be based on? A. That would depend upon the facility itself. If the facility filled up at a relatively fast rate, that the facility could go on a cost-based rate, had its cost—had the rates based on the cost that that facility submitted to use and the minimum period that we have that I can remember of setting a rate is three months at 90 percent occupancy or better. Normally it is six months at 90 percent or better.
>
> Q. Who would make the determination? Was that something at the option of the facility?

A. *During that time it was at the option of the facility to submit as cost-based to us . . .*" (236). (emphasis supplied)

Split Rock's accountant, Mr. Sidney Feld, confirmed the testimony of the Department's employees. His knowledge of the applicable rules came from discussions with Health Department officials:

"Q. As a result of those discussions, did you have an understanding of what the proper procedure was? A. Yes.

Q. What was your understanding? A. My understanding was that any period that was less than a calendar year did not have to be certified and the home at its option had a right to present a six-months report if they wanted to change or break other than the group average.

Q. Was it your understanding that during the first year of operation a facility's costs would not be used unless it requested costs to be used? A. That is correct.

Q. And was it your understanding that the manner of the request would be the presentation of a six month report? A. That is correct" (257).

Moreover, Split Rock did not meet the second requirement for establishing a cost-based rate: a report for six consecutive months at 90 percent utilization was never filed. Therefore, the Department did not have a legal basis for formulating a rate based on actual costs.

Split Rock filed an annual report for 1971 which included costs incurred prior to the date it admitted patients, and showed an occupancy rate of 89.2 percent.

When the HE-2P was reviewed, the Department prepared a rate calculation sheet (Exhibit A at the hearing) stating explicitly that Split Rock's 1971 utilization was 89.2 percent (119, 174; Exhibit A at 334). The hearing officer made the same finding—that Split Rock's utilization in 1971 was 89.2 percent (29). But the Department thereafter substituted its own finding of fact, declaring that Split Rock's utilization was 98.4 percent (34)—a finding which has no support in the record and was arrived at by manipulating the statistical data.

The Health Department's determination in 1972—that occupancy was 89.2%—was based on the 365 day period covered by the home's 1971 HE-2P, the only cost report submitted for that year. After the hearing, the Department increased the utilization to 98 percent by reducing the reporting period to 331 days (34).

The Department's belated attempt to raise the utilization above 90% should not be countenanced by this Court. It is inconsistent not only with its own initial determination in 1972, but with the factual determination of its own hearing officer as well. And most importantly, it fails to establish that the requisite 90% was maintained for six consecutive months.

Under the circumstances, since the facility did not elect to be reimbursed on the basis of actual costs during its initial year of operation, the Department has no legal basis for denying group average reimbursement.

CONCLUSION.

The petition should be granted in all respects.

Respectfully submitted,

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Of Counsel

May, 1981

Statement Under Rule 5531 CPLR.

1. The Index No. in the court below is 80-517.

2. The full names of the original parties are: Split Rock Nursing Home, Petitioner; The Office of Health Systems Management of the Department of Health of the State of New York, The Hon. David Axelrod, M.D., Commissioner of Health of the State of New York, Richard A. Berman, Director of the Office of Health Systems Management, Respondents. The names have not been changed.

3. The proceeding was commenced in the Supreme Court, Albany County.

4. The proceeding was commenced on or about March 6, 1980, by service of a Notice of Petition and a Petition.

5. Petitioner brought this proceeding to review a determination made by an administrative agency.

6. This is a petition for a judgment pursuant to CPLR Article 78 annulling, vacating and setting aside an order issued by the New York State Department of Health, dated January 30, 1980, after an administrative hearing, sustaining a reduction in the Medicaid reimbursement received by Split Rock Nursing Home. The proceeding was transferred to this Court on May 14, 1980, by order of the Supreme Court, Albany County (Klein, J.) pursuant to CPLR 7804 (g).

7. Review is on the full record, reproduced.

APPENDIX B—Petitioner's Reply Brief.

Argued by
DAVID B. BERNFELD
(30 MINUTES REQUESTED)

NEW YORK SUPREME COURT

APPELLATE DIVISION—THIRD DEPARTMENT

In the Matter of the Application of

SPLIT ROCK NURSING HOME,

Petitioner,

For a Judgment Pursuant to Article 78 of the Civil Practice Law and Rules

against

THE OFFICE OF HEALTH SYSTEMS MANAGEMENT OF THE DEPARTMENT OF HEALTH OF THE STATE OF NEW YORK, THE HON. DAVID AXELROD, M.D., Commissioner of Health of the State of New York, RICHARD A. BERMAN, Director of the Office of Health Systems Mangement,

Respondents.

PETITIONER'S REPLY BRIEF

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SUPREME COURT OF THE STATE OF NEW YORK

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Respondents.

PETITIONER'S REPLY BRIEF.

Preliminary Statement.

This brief is submitted in reply to some of the arguments made by respondents in their brief to this Court.

POINT.

Respondents cannot rely upon an audit report for revoking petitioner's incentive allowance.

Respondents contend that Split Rock Nursing Home was not entitled to an incentive allowance because the facility had significant operating deficiencies. To support that contention respondents have constructed a new definition of significant operating deficiencies, which is neither reasonable nor rational. Indeed, that definition is contradicted by the testimony at the hearing and is inconsistent with the Health Department's own regulations.

Respondents claim that a significant operating deficiency "relates to the overall conduct of an operator" and includes "the propriety of the information submitted in the HE-2P report * * * as well as the allotment of costs to various categories which may be found to be improper" [Brief at p. 38] and attempt to utilize that definition to urge that a 1975 audit report "disclosed" that petitioner had significant operating deficiencies in 1971. But the testimony at the hearing (quoted at length in our main brief at pp. 10-11) made it clear that significant operating deficiencies have nothing to do with audits, the information contained on the HE-2P, or the allotment of costs. Instead they relate solely to the adequacy of care.

Significant operating deficiencies concern the manner in which the nursing home was operated as revealed by the "latest survey". Thus, 10 N.Y.C.R.R. Part 86.31, provides:

> "Incentive allowance; proprietary nursing homes. Within the rate of payment for proprietary

allowable cost which is equal to percentage established by the Commissioner to represent a sharing in the amount by which the total costs of administrative, dietary and housekeeping services of an individual facility are lower than the weighted average ceiling of the costs of these services for the group. In instances *where the latest survey disclosed significant deficiencies in the operation of a facility,* the incentive allowance will not be available" (emphasis added).

The "survey" referred to is an inspection to determine "the adequacy of care being rendered" by the facility as mandated by Public Health Law Section 2803(1) (effective until March 1, 1978): surveyors seek to determine if the facility is complying with 10 N.Y.C.R.R. Part 700 *et seq. Cf. Massena v. Whalen,* 72 A.D.2d 838 (3rd Dept. 1979). The "survey" has nothing to do with an audit which is an after-the-event review of prior fiscal and statistical records and reports of the nursing home. 10 N.Y.C.R.R. 86-1.8. That is why the Department's Chief Auditor, Mr. Marvin Kern, testified unequivocally that disallowance of an incentive was "not an audit function" (219); rather it is, according to Ms. Wall, the Department's Chief Fiscal Analyst, within the ambit of the professional surveyors (141-42).

The policy considerations which underlie the withholding of an incentive allowance to a facility with significant operating deficiencies is to prevent operators from reducing their costs by reducing the level of care provided to patients. That is why the regulations refer to "survey" and to "the operation of a facility"—and why the S.O.D. list consisted solely of facilities with deficiencies identified and reported by program personnel, not by audit results.

Respondents' attempt at constructing a new definition of significant operating deficiencies is contrary to the evidence and the regulations, as well as common sense, and should be rejected by this Court.

Conclusion.

The petitioner should be granted in all respects.

Respectfully submitted,

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August, 1981